Nos. 83-1321, 83-1432, 83-1433, 83-1442, 83-1443 and 83-1618

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

NORTHWEST PIPELINE CORPORATION, *et al.*,
Petitioners,

v.

PHILLIPS PETROLEUM COMPANY, *et al.*,
Respondents.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF IN OPPOSITION OF THE PLA RESPONDENTS

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QUESTION PRESENTED

Whether, under section 1(b) of the Natural Gas Act, there is a "sale in interstate commerce of natural gas for resale" when leases covering potential gas-bearing lands are transferred to an interstate natural gas pipeline for the purpose of the pipeline's exploration, development and operation of the properties and

(i) no cash consideration is paid at the time of transfer for any natural gas underlying such leases, on the basis of agreed-upon reserve estimates or otherwise, and

(ii) the lease acreage is not substantially developed by drilling.

LIST OF CORPORATE PARENTS, SUBSIDIARIES AND AFFILIATES

AMOCO PRODUCTION COMPANY

Amoco Production Company is a wholly owned subsidiary of Standard Oil Company (Indiana).

The subsidiaries and affiliates (not wholly owned by Standard Oil Company (Indiana) or a wholly owned subsidiary) of Amoco Production Company are:

Amoco Australia Limited
Amoco Canada Petroleum Company, Ltd.
Amoco Credit Corporation
Amoco Oil Holdings S.A.
Amoco (U.K.) Exploration Company
Analog Devices Inc.
Cetus Corporation
Cyprus Mines Corporation

ATLANTIC RICHFIELD COMPANY

The subsidiaries and affiliates of Atlantic Richfield Company are:

Alpart Farms (Jamaica) Ltd.
Alumina Contractors Limited
Alumina Partners of Jamaica
Alyeska Pipeline Service Company
The Ambler Mining Company
Anaconda Exploration New Zealand Limited
Anaconda Holdings Do Brasil LTDA
Anaflex S.A. de C.V.
Anamax Mining Company
ARCO Australia Coal Pty. Ltd.
ARCO Solar Nigeria Ltd.
Arilan, S.A. de C.V.
Arpet Petroleum Limited
A/S Skaland Grafitiverk
Atlantic Richfield de Mexico, S.A. de C.V.

Aughinish Alumina Limited
Aughinish Estates Limited
Aughinish Finance Limited
Aughinish Property (Nominees) Limited
Badger Pipeline Company
Bingham Development Company
Black Lake Pipe Line Company
Blair Athol Coal Pty., Limited
The British American Metals Company, Limited
Candel International Limited
Caribou-Chaleur Bay Mines Ltd.
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Chile Copper Company
Cobre de Hercules, S.A.
Cobre de Mexico, S.A.
Cobrecel, S.A. de C.V.
Colonial Pipeline Company
Compania de Petroleo Ganso Azul, Ltda.
Compania Minera Dos Republicas, S.A. de C.V.
Compania Minera Kappa, S.A.
Compania Minera Penacobre, S.A.
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Cupro San Louis, S.A. de C.V.
Curragh Coal Sales
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Dexter de Mexico, S.A.
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East Texas Salt Water Disposal Co.
85819 Canada Limited
Eisenhower Mining Company
Empresa de Comercio Exterior Mexicano, S.A. de C.V.
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Impulsora De Cobre, S.A. de C.V.
Industrias Nacobre, S.A. de C.V.
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Jamaica Alumina Security Company, Ltd.
Kenai Pipe Line Company
Kronos, Computacion y Teleproceso, S.A. de C.V.
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Kuparuk Transportation Company
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Sinclair Venezuelan Oil Company
Smoke House Copper Mining Company
Sociedada Anonima Marvin
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Union de Credito Industrial Vallejo, S.A.
United Park City Mines Company
The Walworth Company
West Mayflower Mining Company
William Prym de Mexico, S.A.

GETTY OIL COMPANY

The stock of Getty Oil Company has been acquired by Texaco Inc.

Getty Oil Company has no subsidiaries and affiliates which are not wholly owned whose securities are publicly traded in the United States or Canada.

The subsidiaries and affiliates (not wholly owned) of Texaco Inc., as reported in the petition for writ in No. 83-1171, are:

Caltex Australia Limited
Duetsche Texaco Aktiengesellschaft, S.I.A.M.
Koa Oil Company
Korea Tanker Company Limited
Texaco Canada Inc.
Texaco Ghana Limited

Texaco Mexicana, S.A. de C.V.
Texaco Nigeria Limited
Texaco Togo
The Great Eastern Oil & Import Co. Limited

MOBIL OIL CORPORATION

Mobil Oil Corporation is a wholly owned subsidiary of Mobil Corporation.

The subsidiaries and affiliates of Mobil Oil Corporation or Mobil Corporation, whose securities are available for purchase by United States citizens, are:

Marcor Inc.
Mobil Alaska Pipeline Company
Montgomery Ward & Co., Incorporated
Montgomery Ward Credit Corporation
Toa Nenryo Kogyo Kabushiki Kaisha

PHILLIPS PETROLEUM COMPANY

The subsidiaries and affiliates of Phillips Petroleum Company are:

Acurex Corporation
Arctic LNG Transportation Company
Bruin Carbon Dioxide Corporation
Calatrava, Empresa para la Industria Petroquimica, S.A.
Canyon Reef Carriers
Cochin Refineries Limited
East Texas Salt Water Disposal Company
Heat Transfer Research, Inc.
Kenai LNG Corporation
Oil Insurance Limited
Papago Chemicals, Inc.
Phillips Carbon Black Limited
Phillips Gas Supply Corporation
Phillips Pacific Chemical Company
Plasticos Vanguardia, S.A.

Polar LNG Shipping Corporation
The Salk Institute Biotechnology
White River Shale Oil Corporation
Aero Oil Company
Canada Western Cordage Company Limited
Chisholm Pipeline Company
Norsea Gas A/S
Phillips Carbon Black Company (Proprietary) Limited
Phillips Carbon Black Italiana S.p.A.
Phillips Petroleum Singapore Chemicals (Private) Limited
Everglades Pipe Line Company
Explorer Pipeline Company
Kaw Pipe Line Company
Nordisk Kemi AB
Nordisk Philblack AB
Norland GmbH Fur Grundbesitz Und Industrieanlagen
Norpipe Petroleum UK Limited
Norsea Gas GambH
Quimica Venoco C.A.
Renalit—Fertighaus GmbH
Seadock, Inc.
Seaway Pipeline, Inc.
Spodco-USA, Inc.
Texas Offshore Port, Inc.
Venezoil, C.A.
Western Desert Operating Petroleum Company
Colonial Pipeline Company
Compagnie Francaise Du Carbon Black
Dixie Pipeline Company
Drisco, S.A. de C.V.
Industrias Negromex, S.A. de C.V.
Petrochim
Spodco Limited
Trenwick Limited
Great Yarmouth Port Labour Company Limited

Norsea Pipeline Limited
Phillips-Imperial Petroleum Limited
(owned by Subsidiary of Phillips Petroleum Company United Kingdom Limited)
Philmac Oils Limited
Philmac Panama Incorporated
Sevalco (Holdings) Limited
Iranian Marine International Oil Company ("Iminoco")
Alyeska Pipeline Service Company
Insurance & Reinsurance Brokers (Bermuda) Limited
Norpipe a.s.

T.H. McELVAIN OIL AND GAS PROPERTIES, *et al.*

None of the parties to PLA-4 (T.H. McElvain Oil and Gas Properties, *et al.*) is a corporation. The list of the parties to PLA-4 which appears in the various Petitions for Certiorari should be corrected to read as follows:

T. H. McElvain Oil and Gas Properties
Grace M. Brown
Catherine B. McElvain
T. H. McElvain, Jr.
Catherine M. Harvey
James E. McElvain, Executor of Estate of Carl R. McElvain
Nancy Ridgely
Brenda V. Petke
James M. Raymond, as Trustee of Estate of F.B. Miller
Corrine Miller Gay Trust
Maydell Miller Mast Trust
Maybelle Miller Nestler Trust
Ruth M. Vaughn

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BRIEF IN OPPOSITION OF THE PLA RESPONDENTS

Respondents Amoco Production Company, Atlantic Richfield Company, Getty Oil Company, Mobil Oil Corporation, Phillips Petroleum Company, and T.H. McElvain Oil and Gas Properties, *et al.* ("the PLA respondents") respectfully request that this Court deny the petitions for writ of certiorari seeking review of the judgment of the United States Court of Appeals for the Fifth Circuit in this case.[1]

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[1] Petitions for a writ of certiorari have been filed by the People of the State of California, *et al.* ("California") (No. 83-1321); the Public Utility Commissioner of Oregon, *et al.* ("Oregon") (No. 83-1432); Northwest Pipeline Corporation, *et al.* ("Northwest") (No. 83-1433); El Paso Natural Gas Company ("El Paso") (No. 83-1442); Pacific Gas and Electric Company, *et al.* ("PG&E") (No. 83-1443); and the Federal Energy Regulatory Commission ("FERC") (No. 83-1618). Citations to the various petitions will be in the form "California Pet. at ——." The Appendix prepared by California will be cited as "Pet. App. at ——." A complete listing of all the parties to this case appears in the FERC Pet. at ii to xi.

STATEMENT OF THE CASE

A. Background of the Litigation

This case involves a series of agreements entered into in the 1950s by El Paso Natural Gas Company and Pacific Northwest Pipeline Corporation[2] with the holders of lease rights to possible gas-bearing lands in the San Juan Basin area of New Mexico and Colorado.[3] Under the agreements, the leaseholders conveyed to El Paso and Pacific Northwest the right to explore for and produce gas from certain geological formations underlying the leasehold acreage. In exchange, the leaseholders retained an overriding royalty on all gas produced by the pipelines from these leases. The overriding royalty in each agreement was stated in terms of cents per thousand cubic feet of gas, subject to escalation and possible redetermination at stated intervals of time. The agreements provided that the leaseholders were not to be involved in exploration or production; all such operations were to be performed by or on behalf of the pipelines. *See* Pet. App. at 126a-127a.

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[2] After the agreements were made and implemented, El Paso acquired Pacific Northwest. Subsequently, El Paso was ordered by this Court to divest its acquisition, *United States v. El Paso Natural Gas Co.*, 376 U.S. 651, 662 (1964); *see also Utah Public Service Commission v. El Paso Natural Gas Co.*, 395 U.S. 464 (1969); *Cascade Natural Gas Corp. v. El Paso Natural Gas Co.*, 386 U.S. 129 (1967), resulting in the creation of the present Northwest Pipeline Corporation in February 1974. The agreements originally made by Pacific Northwest, known as Pacific Lease Agreements (PLAs), were transferred to Northwest Pipeline at divestiture. The essentially identical agreements retained by El Paso are called Gas Lease Agreements (GLAs). *See* Pet. App. at 38a.

[3] These leaseholders (or their successors), which include both corporations and a large number of individuals, are the respondents in the present case. The parties sponsoring this Brief are denominated the PLA respondents because they have PLA agreements with Northwest. *See* note 2 *supra*. One of the PLA respondents, Atlantic Richfield Company, also has a GLA agreement with El Paso and therefore is a signatory of the separate Brief in Opposition of Respondents Tenneco Oil Company, *et al.*

From their inception, these agreements were treated by all concerned, including the Federal Power Commission,[4] as nonjurisdictional lease transactions, rather than sales in interstate commerce of natural gas for resale. In every pipeline rate case from the mid-1950s until this litigation was begun, the Commission reviewed and allowed in the pipelines' cost-of-service the overriding royalties paid by El Paso and Northwest. The Commission's lack of jurisdiction over the lease sales was never questioned in any of those cases.[5]

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[4] Both the Federal Power Commission and its successor the Federal Energy Regulatory Commission will be referred to herein as "the Commission."

[5] In fact, the Commission's treatment of the lease sales as nonjurisdictional went beyond mere passive acquiescence. In *Phillips Petroleum Co.*, Opinion No. 338, 24 F.P.C. 537 (1960), *rehearing denied*, 24 F.P.C. 1008 (1960), *aff'd*, *Wisconsin v. FPC*, 303 F.2d 380 (D.C. Cir. 1961), *aff'd*, 373 U.S. 294 (1963), the first independent producer rate case at the FPC, the Commission carefully separated Phillips' jurisdictional costs for its wellhead sales of gas from its nonjurisdictional costs associated with its royalty interests, including primarily the San Juan Basin overriding royalties. *See* 24 F.P.C. at 557, 565; *see also id.* at 664-66 (hearing examiner's discussion of nonjurisdictional status of exploration costs relating to Phillips' PLA agreement). As late as 1973, the Commission expressly reaffirmed that these agreements were not the equivalent of jurisdictional sales of gas. *William G. Webb*, Opinion No. 642, 49 F.P.C. 17 (1973). Distinguishing the "Webb-Turner" lease-sale agreements, which are among those now before this Court, from the agreements held jurisdictional by this Court in *United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392 (1965) ("*Rayne Field*"), the Commission held that the San Juan Basin agreements:

> represented a method evolved by El Paso and the Producers to cause the exploration for and the development of necessary gas supplies . . . . The transactions arose out of the needs of the parties rather than being almost wholly a rearrangement of payments, as in *Rayne*, to accomplish the same result as a conventional sale.

49 F.P.C. at 26.

B. The District Court Proceeding

In 1973, the overriding royalty under one of the agreements was increased substantially as the result of arbitration pursuant to the redetermination provision in the agreement. In reaction, El Paso filed a complaint in district court, alleging for the first time[6] that these transactions were subject to Commission jurisdiction as "sales of gas" under the Natural Gas Act.[7] Subsequently, El Paso and Northwest both filed complaints with the Commission, raising the same claim. The Commission, at the urging of its staff, refused to act on the complaints,[8] choosing instead to defer to the district court. *See* Pet. App. at 37a & n.7.[9]

In January 1977, following a lengthy trial, the district court ruled that these transactions were not jurisdictional under the Natural Gas Act. Pet. App. at 121a. Applying the principles of *Rayne Field*, *see* note 5 *supra*, the district court rested its decision on three major factors: (1) the absence of proven reserves at the time the agreements were made; (2) the lack of substantial development of the properties at that time; and (3) the fact that the lease sales were not the economic equivalent of conventional gas sales but were unique transactions formulated to meet the needs of the parties. *Id.* at 131a-133a.

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[6] In the *Webb* case, *see* note 5 *supra*, El Paso had urged the Commission to hold the lease sales nonjurisdictional.

[7] After the divestiture of Northwest by El Paso, *see* note 2 *supra*, Northwest joined the suit as a plaintiff.

[8] Significantly, the Commission staff took the position at the time that, if the Commission were to address the issue of jurisdiction, it should find the San Juan Basin lease sales nonjurisdictional. *See* Docket No. CP74-314, Staff's Comments to Complaint of El Paso Natural Gas Company and Request for an Order to Show Cause at 4-8 (July 19, 1974). The relevant portion of the staff's 1974 analysis of this issue is set forth in the Appendix to this Brief.

[9] Subsequently, El Paso and Northwest entered into interim settlements with the GLA and PLA royalty owners regarding the level of overriding royalties.

The court began its analysis by examining the agreements made with El Paso. On the issue of proven reserves, the court found that "[t]he GLAs in issue were not transfers of leases with proven reserves, since no reasonable estimate of recoverable reserves underlying the specific acreage conveyed could be made at the time [each] respective GLA was executed." *Id.* at 131a. With respect to substantial development, the court likewise determined that the GLA acreage fell short of meeting the jurisdictional test. "Where wells had been drilled," the court observed, "the number was exceptionally low compared to the number of available drilling sites. Wells in the Basin generally were incapable of recovering commercially significant amounts of gas." *Id.* at 132a. Moreover, the court found, "[t]he GLAs themselves indicate that the parties negotiated for undeveloped acreage. . . . Each transaction made sense economically, only if undeveloped acreage were transferred. . . ." *Id.* at 133a.

Regarding the final factor, economic equivalency to conventional sales, the court found the San Juan Basin lease sales distinguishable from the transactions held jurisdictional by this Court in *Rayne Field.* "The parties did not enter into the GLAs as a means of shifting payments as in *Rayne Field,*" the court commented.[10] "Rather, these agreements arose from the unique economic situation of the parties and reflected their efforts to structure the transactions so that El Paso would explore for and de-

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[10] The district court rejected the assertion—advanced here by nearly all the petitioners—that the events concerning the Barker Dome Field, which preceded the transactions here at issue, evidenced an intent of the parties to the GLAs and PLAs to evade Commission jurisdiction. *See, e.g.*, El Paso Pet. at 4-6; FERC Pet. at 4-5. "[T]he history of the Barker Dome agreement is not analogous to the agreements here at issue," the court said. "The negotiations surrounding Barker Dome reflect El Paso's efforts to enter the San Juan Basin. Once El Paso was certified, it held a virtual monopsony in the Basin . . . ." Pet. App. at 125a n.5.

velop gas reserves in the Basin." *Id.*[11] The court made virtually identical findings with regard to PLA-13, the only Northwest agreement then at issue. *Id.* at 133a-134a.

Based on these findings, the district court concluded that the lease transactions were nonjurisdictional. "Because no agreement was the economic equivalent of a gas sale contract," the court stated, "and because the leases transferred were neither proven nor substantially developed at the time of the execution of those agreements, each agreement at issue in this litigation . . . is not a 'sale in interstate commerce of natural gas for resale' . . . ." *Id.* at 134a-135a.

C. The Commission Proceeding

After the district court issued its decision, the Commission instituted a show-cause proceeding to reconsider the question of its jurisdiction over the San Juan Basin lease sales.[12] A Commission administrative law judge reheard the issues raised in the district court and entered an initial decision contrary to the district court's opinion.

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[11] The district court explained that El Paso, which was regulated on a cost-of-service basis, could afford to explore for and produce gas in an area such as the San Juan Basin, while independent producers, who were limited by the price the pipeline was willing to pay, could not. Pet. App. at 128a n.13. The district court attributed the format of the lease sales to these economic circumstances and not to any intent to escape Commission regulation.

[12] Respondents filed a petition for review challenging the institution of the Commission proceeding on res judicata and collateral estoppel grounds. Without reaching the issues presented, the Fifth Circuit directed the Commission to proceed, and deferred action on the pipelines' appeal of the district court decision pending receipt of the Commission's opinion. Pet. App. at 137a. Because the Fifth Circuit ultimately decided the jurisdictional issue on the merits, it never reached the collateral estoppel and res judicata issues. Pet. App. at 19a.

The administrative law judge concluded that the lease-sale transactions were the economic equivalent of conventional gas sales and were therefore subject to the Commission's jurisdiction. Pet. App. at 33a-120a.

On September 25, 1980, the Commission reversed its stance of almost thirty years and adopted the initial decision as its own opinion.[13] Following the denial of rehearing, petitions for review of the Commission decision were filed and consolidated with the pipelines' pending appeal from the district court decision.

D. The Court of Appeals Decision

The court of appeals unanimously affirmed the district court's conclusion that these transactions were not jurisdictional, and reversed the Commission's contrary conclusion. It started with an examination of this Court's decision in *Rayne Field*, which it termed the "fountainhead decision setting forth the factors to apply in determining whether a transaction is jurisdictional." Pet. App. at 11a. In *Rayne Field*, the Fifth Circuit explained, the Supreme Court "directed a case-by-case analysis of hybrid lease-sale arrangements, the fundamental inquiry being whether 'the sales of these leases in . . . a proven and substantially developed field . . . accomplished the transfer of large amounts of natural gas to an interstate pipeline company for resale in other states.' " *Id.* at 12a, quoting 381 U.S. at 401. Relying on its decision in *Continental Oil Co. v. FPC*, 370 F.2d 57 (5th Cir. 1966), *cert. denied*, 388 U.S. 910 (1967) ("*Ship Shoal*"), the court of appeals found three factors to be relevant to the *Rayne Field* determination: (1) whether "the economic effect of the transfer [is] similar to that of a conventional sale"; (2) whether "the subject of the transaction [is] 'proven and substan-

[13] In its order, the Commission initiated a remedy proceeding to determine whether any refunds were due as a result of its jurisdictional finding, the amount of any such refunds, and the level of future overriding royalties. The remedy proceeding was suspended immediately following the Fifth Circuit's decision.

tially developed' reserves"; and (3) whether "the transfer of the reserves [is] for [the] purpose of interstate transmission and resale." Pet. App. at 12a, quoting 370 F.2d at 62.[14]

Applying this test to the facts at hand, the court of appeals discerned a fundamental error in the Commission's approach to the jurisdictional issue. "In determining whether a transfer is jurisdictional under the [Natural Gas] Act," the court stated, "*Ship Shoal* teaches that all three of the above factors must be present. The administrative law judge and the Commission, however, elevated the first prong—economic equivalency—from a component in the *Rayne Field* test to the determinative factor on the issue." Pet. App. at 12a-13a. "Carried to its logical conclusion," the court reasoned, "the Commission's economic equivalency/commercial realities approach could render any sale of lease rights to an interstate pipeline company jurisdictional merely because the transaction ultimately results in successful production and disposition of gas in interstate commerce." *Id.* at 14a.

Because its opinion focused on this critical flaw in the Commission's reasoning, the Fifth Circuit had no occasion to address two of the district court's principal findings, namely, that the lease-sale agreements were not economically equivalent to conventional gas sales and that they did not constitute transfers of proven reserves.[15] Instead, the court of appeals affirmed the result reached

[14] The court further noted that, under *Ship Shoal*, the "proven and substantially developed" test has two aspects: "(1) definability of gas volume based upon proof of reserves and (2) imminent ability to produce in commercial quantities." Pet. App. at 12a, citing 370 F.2d at 63-64.

[15] While the court of appeals did comment in passing that "the reserves in the Basin may well have been 'proven' at least within reasonable estimates," *id.* at 15a, the court did not address the question directly, nor did it overturn the district court's finding that the reserve estimates at the time covered the entire San Juan Basin, leaving the volume of reserves underlying particular tracts highly uncertain. *See id.* at 131a n.19.

by the district court solely on the ground that "the lease-sale agreements did not involve substantially developed reserves, and the Commission erred in determining [that they] did." *Id.* at 15a. Expressly adopting the district court's finding that "actual drilling is the only method of definitely locating recoverable gas saturations [in the San Juan Basin]," *id.* at 9a, the Fifth Circuit found the "limited extent to which the Basin had been drilled at the time the GLAs and PLAs were executed" an "important factor" in evaluating whether the agreements were jurisdictional, *id.* at 15a. "While the number of wells existing at execution of the agreement is not the *sine qua non* of substantial development," the court stated, "the Commission has considered this factor, and the cases point up its significance." *Id.* at 16a, citing *Rayne Field* and *Texas Gas Transmission Corp.*, 3 FERC ¶ 61,135 (1978). Since the evidence below revealed that "the few wells in the ground when the agreements were executed could not have come close to depleting the acreage," Pet. App. at 16a,[16] the court of appeals concluded that "the acreage was not substantially developed [and] the agreements in issue were not sales of gas under the Natural Gas Act," *id.* at 17.

Petitioners sought rehearing and rehearing *en banc* of the unanimous decision of the Fifth Circuit panel. Despite petitioners' vigorous assertions of an intracircuit conflict (which they have renewed here), the requests for rehearing and rehearing *en banc* were denied on December 2, 1983, without having attracted any votes. Pet. App. at 152a. Petitions for a writ of certiorari were subsequently filed by six separate parties or groups of parties. *See* note 1 *supra*.

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[16] In fact, the court noted, a number of the agreements covered acreage on which no wells existed at the time of execution. The Phillips PLA, for example, involved 188,000 acres which did not contain a single well. *Id.* at 16a. By 1977, 365 wells had been drilled on this acreage, *id.*, and the number has increased substantially since then.

SUMMARY OF ARGUMENT

It is well-established that while the Natural Gas Act vested the Commission with jurisdiction over wellhead sales of gas in interstate commerce, transfers of gas leases are normally outside the Commission's jurisdiction. *Compare, e.g., Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), *with Mobil Oil Corp. v. FPC*, 463 F.2d 256 (D.C. Cir. 1971), *cert. denied*, 406 U.S. 976 (1972). An exception is made when the conveyance of a gas lease in a "proven and substantially developed field" transfers an agreed-upon volume of gas reserves in place. When such a transaction is the functional equivalent of a wellhead sale of gas, this Court has held that it can constitute a jurisdictional sale. *Rayne Field*, 381 U.S. at 401.

Applying the *Rayne Field* standard, the courts below held that the lease-sale transactions at issue here were not sales of gas under the Natural Gas Act. Contrary to petitioners' assertions, this decision does not present an issue of broad legal significance, nor does it threaten to undercut Commission jurisdiction or to inflict significant financial harm on gas consumers.

The Fifth Circuit's decision is fully consistent with other cases in this well-defined field of law and plainly does not alter the jurisdictional standard established by this Court in *Rayne Field*. Petitioners have not advanced any persuasive argument to justify abandonment of the *Rayne Field* test. Their proposal to delete the "proven and substantially developed" element from the jurisdictional standard disregards the express statutory limitations on Commission jurisdiction and ignores the key role this requirement plays in the determination whether what is sold is gas, or merely the right to find and produce gas. Indeed, the Commission itself has recognized that, in the absence of substantial development, no "sale of gas" within the meaning of the Natural Gas Act is possible. *See Texas Gas Transmission Corp.*, 3 FERC ¶ 61,135 (1978).

In addition, the unique circumstances presented here, together with recent developments in the field of natural gas regulation, strongly indicate that this case is now *sui generis*. This Court's decision that the first-sale provisions of the Natural Gas Policy Act of 1978 ("NGPA"), Pub. L. No. 95-621, 92 Stat. 3350, 15 U.S.C. §§ 3301 *et seq.*, apply to pipeline-produced gas, *Public Service Commission v. Mid-Louisiana Gas Co.*, 103 S. Ct. 3024 (1983), makes it highly unlikely, for practical reasons, that the issue raised here will ever recur. Furthermore, even if this issue were to arise again, the enactment of the NGPA has substantially altered the statutory scheme under which it would be decided. There is thus no need for this Court to make elaborate refinements on the jurisdictional standard applicable under the Natural Gas Act, nor is there any prospect that an "attractive gap" will be opened in the regulatory scheme.

Petitioners contend that, unless overturned, the decision below will cause serious financial harm to gas consumers on the West Coast. To the contrary, there is no significant prospect that the decision will increase the future cost of gas to consumers. Nothing in the decision below affects the Commission's longstanding jurisdiction to control the rates the pipelines charge their customers. Moreover, absent extraordinary Commission action, consumers cannot be required to pay more for this gas than the applicable NGPA ceiling prices, regardless of the outcome of this case. Given additionally that the prospect of retroactive refunds in this case is at best highly speculative, the claim that the public will suffer if the decision below is not reversed must be viewed with great skepticism.

In summary, the decision below has little precedential significance. It will not affect the scope of Commission jurisdiction in the future, nor does it open any gap in the regulatory scheme. Its impact, either prospective or retroactive, on the gas-consuming public is minimal. For these reasons, review by this Court is both unnecessary and unwarranted. The petitions for certiorari should therefore be denied.

REASONS FOR DENYING THE WRIT

I. PETITIONERS HAVE PRESENTED NO SIGNIFICANT LEGAL ISSUE WARRANTING THIS COURT'S ATTENTION

The issue in this case is whether, under section 1(b) of the Natural Gas Act, the particular lease-sale transactions involved here are subject to the jurisdiction of the Commission. The courts below, applying the established *Rayne Field* test, held that they are not. Petitioners challenge that determination on two basic grounds: first, that the *Rayne Field* test is wrong and should be revised, and second, that even if *Rayne Field* articulated the proper jurisdictional test, the court below misapplied that test. Neither of these contentions raises an issue worthy of this Court's review.

A. The *Rayne Field* Test, Including the 'Proven and Substantially Developed' Element, Is the Proper Jurisdictional Standard

Petitioners are virtually unanimous in suggesting that this Court should eliminate one of the key elements of the *Rayne Field* test, namely, the requirement that the reserves in question be substantially developed. El Paso's petition states, for example, that "it makes no sense to require that the lease sale acreage be substantially drilled." El Paso Pet. at 14; *see also* California Pet. at 15; Northwest Pet. at 24.[17] Petitioners apparently would prefer a test under which any conveyance of an interest in possible gas-bearing lands would be subject to Commission jurisdiction if the transaction ultimately leads to

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[17] El Paso, like several of its co-petitioners, painstakingly edits out the critical language from the Court's statement in *Rayne Field* that the lease sales there, which involved "*a proven and substantially developed field*, accomplished the transfer of large amounts of natural gas to an interstate pipeline company for resale in other States." 381 U.S. at 401 (emphasis added). *Compare* El Paso Pet. at 14; Northwest Pet. at 18; California Pet. at 17 (all omitting the phrase italicized above).

the production of gas for sale in interstate commerce by a natural gas pipeline company.

Contrary to petitioners' assertions, however, the "proven and substantially developed" test is a well-established and essential component of the jurisdictional standard under the Natural Gas Act. *See Rayne Field*, 381 U.S. at 401-03; *Ship Shoal*, 370 F.2d at 62. It is a critical element in distinguishing nonjurisdictional land transactions from jurisdictional sales of natural gas. The function of this test is to determine, precisely as the Commission has stated the issue in its petition, "whether what [is] sold [is] gas or merely the right to explore for gas." FERC Pet. at 19.

The test reflects the elementary fact, accepted everywhere in the industry, that the question whether, and to what extent, gas underlies particular acreage cannot be answered in the absence of actual drilling which penetrates the gas-bearing sands.[18] It is this penetration of productive sands which permits a determination (by core analysis, electric log or other means) of the actual presence of natural gas. Absent such a determination, there plainly cannot be a "sale of gas" over which Congress has given the Commission authority.[19]

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[18] The disclosure regulations of the Securities and Exchange Commission, for example, limit the classification of reserves as "proved" to those areas of a reservoir "delineated by drilling and defined by gas-oil and/or oil-water contacts, if any, and . . . the *immediately adjoining* portions not yet drilled, but which can be reasonably judged as economically productive on the basis of available geological and engineering data." 17 C.F.R. § 210.4-10(a)(2)(i) (1983) (emphasis added). Natural gas "that may occur in undrilled prospects" cannot be classified as "proved reserves." *Id.* § 210.4-10(a)(2)(iii)(C); *see also id.* § 210.4-10(a)(4). The standards for "proved, developed" reserves are even more stringent; only "reserves that can be expected to be recovered through existing wells with existing equipment" can be classified as "proved, developed." *Id.* § 210.4-10(a)(3).

[19] The "proven and substantially developed" test reflects this basic physical fact. The mere presence of geology favorable to the

This Court recognized as much in its landmark decision in *Rayne Field.* First, the Court linked the substantial development of the Rayne Field reserves to the "significant and determinative economic fact" that the lease sales "in Rayne Field, *a proven and substantially developed field,* accomplished the transfer of large amounts of natural gas to an interstate pipeline company." 381 U.S. at 401 (emphasis added). The Court thus acknowledged that the Rayne Field lease sales would not have been sales of *gas* without substantial development which permitted verification of the estimated reserves thought to underlie the acreage.

Second, the *Rayne Field* Court expressly relied on the substantial development of the Rayne Field reserves to distinguish *FPC v. Panhandle Eastern Pipe Line Co.,* 337 U.S. 498 (1949), which had held that sales of undeveloped leases fall within the "production or gathering" exemption of section 1(b). 381 U.S. at 403-04. *Panhandle,* the Court said, did not pose the "present problem—whether the transfer to an interstate pipeline company for transmission and resale in interstate commerce of *proven and substantially developed* gas reserves is subject to Commission jurisdiction." *Id.* at 404 (emphasis added). As the Court explained:

> The substantiality of development is a relevant consideration for the more that must be done before the gas begins its interstate journey, the less the transaction resembles the conventional wellhead sale of natural gas in interstate commerce which . . . the Act has affirmatively placed within Commission jurisdiction.

Id. at 403.[30]

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accumulation of gas does not insure that there is a commercial accumulation, or indeed any accumulation at all. This is attested to by the fact that dry holes are frequently drilled, even in producing fields.

[30] The Commission argues that, while substantial development is "a relevant consideration," it cannot be the dispositive factor in a

The Commission itself has recognized that substantial development is a crucial component of the jurisdictional test. In *Texas Gas Transmission Corp.*, 3 FERC ¶ 61,135 (1978), the Commission held a sale of reserves in place nonjurisdictional on the ground that the reserves were not substantially developed.[21] The issue of the importance of the substantial development test thus does not raise a serious legal question requiring this Court's attention.

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particular case. FERC Pet. at 14-15 (emphasis in original). The import of this distinction is unclear: if the substantiality of development can never affect the outcome of a particular case, it is hard to see how it is relevant. In any event, the Commission's contention that substantial development cannot be viewed as "an essential predicate to jurisdiction," *id.* at 15, is not supported by the evidence cited. The observation, for example, that a sale of natural gas can occur "'before production or gathering is ended,'" *id.*, quoting 381 U.S. at 402, merely indicates that, under certain circumstances, a jurisdictional sale can involve gas that is still in the ground. This principle in no way contradicts the basic *Rayne Field* standard that one of the characteristics defining a jurisdictional sale of gas in place is substantial development through drilling, for the sale of a defined volume of gas in the ground was precisely what *Rayne Field* involved. The same holds for the Commission's observation that the production and gathering exemption relates to the physical process of producing and gathering gas. FERC Pet. at 15, citing 381 U.S. at 402. That truism notwithstanding, substantial development is a logical, firmly grounded prerequisite to the existence of a jurisdictional sale of gas in place.

[21] As the Commission stated:

> Since the [sellers] had not sufficiently developed the field to be able to conduct economically feasible wellhead arrangements, [they] could not have made a conventional wellhead sale to [the buyer] if the parties had so desired. Only 14 wells had been completed, and only 10 of these were productive . . . . Clearly, these are essentially undeveloped reserves requiring further development for feasible production. . . . [I]n our view, the sale of [these] reserves . . . does not constitute a sale for resale in interstate commerce requiring a certificate under Section 7(c) of the Natural Gas Act.

Id. at 61,405-06.

B. The *Rayne Field* Test As Applied Here Does Not Leave an 'Attractive Gap' in the Regulatory Scheme

As shown above, the *Rayne Field* test is the proper standard for judging the jurisdictionality of lease-sale transactions under the Natural Gas Act. Of perhaps equal importance to this Court, the issue of the proper standard under that Act no longer has any real significance beyond the unique facts of this case. Indeed, petitioners have failed to show in any way that the existing *Rayne Field* test leaves an "attractive gap" in the regulatory scheme.

This is so for two major reasons. First, the Natural Gas Act has ceased to be the only statute defining the scope of federal jurisdiction over sales of natural gas. With the enactment of the NGPA in 1978, Congress "comprehensively and dramatically changed the method of pricing natural gas produced in the United States." *Public Service Commission v. Mid-Louisiana Gas Co.*, 103 S. Ct. 3024, 3026 (1983). In particular, while preserving "the Commission's authority under the [Natural Gas Act] to regulate natural gas sales from pipelines to their customers," the NGPA was "designed to supplant the Commission's authority to establish rates for the wholesale market, the market consisting of so-called 'first sales' of natural gas." 103 S. Ct. at 3031. The NGPA explicitly describes the "first sales" subject to its coverage as including the sale of "proven reserves in place." 15 U.S.C. § 3301(22).[22]

Consequently, even for transactions properly characterized as transfers of gas in place, the judicially devel-

[22] Because this provision applies only to the "transfer of title" to reserves, *id.*, it is inapplicable to the GLA and PLA agreements. Even if those transactions could be found to have involved "proven reserves," *compare* Pet. App. at 131a, the transfer of title under the GLAs and PLAs took place several decades before enactment of the NGPA.

oped jurisdictional test under the Natural Gas Act has been supplemented—if not supplanted—by a newly applicable statutory standard. Further refinements on the jurisdictional principles relevant under the prior statute are therefore of limited utility. Since the Natural Gas Act test established in *Rayne Field* does not control the jurisdictionality of lease sales occurring after November 8, 1978, *see* 15 U.S.C. § 3431(a)(1)(A), the relevance of the decision below is effectively confined to the GLA and PLA agreements here, and to comparable transactions, if any exist, that were consummated before the NGPA took effect.[23]

The second reason that the issue raised here lacks broad significance relates to this Court's recent decision in *Mid-Louisiana*, 103 S. Ct. 3024 (1983). By holding in that case that the NGPA's "first sale" definition includes pipeline-produced gas, the Court ensured that NGPA ceiling prices would be applicable whether particular gas reserves were produced by a pipeline or by an independent producer. As the Commission concedes in its brief, "If

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[23] As a factual matter, lease-sale transactions comparable to those in *Rayne Field* have been a relative rarity in the industry. El Paso, for example, cites five, the most recent of which occurred in the early 1960s. El Paso Pet. at 13 n.14. As the district court's opinion clearly indicates, repetition of the specific type of transaction involved in this case is even more unlikely. *See, e.g.*, Pet. App. at 125a-134a. Unique circumstances existing in the San Juan Basin in the early 1950s gave rise to equally unique transactions. These circumstances included the existence of a potentially large but untapped source of gas; the unusual geology of the Basin; El Paso's need for a reliable gas supply to serve the expanding post-World War II California market; El Paso's dependence at the time on frequently interrupted sources of gas produced from wells that were primarily devoted to oil production; the low ratio of gas prices to oil prices; the market power of the pipelines as sole buyers of gas in the Basin; and the lack of incentive for independent producers to incur the costs of developing the San Juan Basin at then-prevailing wellhead prices as compared to the incentive of the pipelines, which could price their production on a cost-of-service basis.

the lease transactions are deemed to be nonjurisdictional, then under *Mid-Louisiana* the pipelines' sales of their production would be considered first sales within the meaning of the NGPA and the pipelines could charge their customers only the applicable NGPA rate . . . ." FERC Pet. at 21. Since NGPA pricing would also be applicable if the lease sales were found jurisdictional, it is now essentially immaterial to the nation's gas consumers which result obtains. Given that the underlying rationale of both the Natural Gas Act and the NGPA is consumer protection, *see Mid-Louisiana*, 103 S. Ct. at 3042 (White, J., dissenting), the issue of jurisdictionality, at least in the kind of circumstances presented here, has become largely irrelevant.

The Commission suggests that the issue is still alive by pointing out that, if a particular lease transaction is held nonjurisdictional, the pipeline involved may find itself with a royalty obligation in excess of the price it can charge its customers. FERC Pet. at 21.[34] Rather than permitting its stockholders to absorb excess royalty costs, it is asserted, the pipeline might seek to shift the burden onto its customers by requesting special relief from the Commission. *Id.* This contention ignores the critical role of the Commission as a guardian of the public interest. Only the Commission has the authority to permit collection of prices in excess of the NGPA statutory ceilings. *See, e.g.*, 15 U.S.C. § 3314(2); *see also Mid-Louisiana*, 103 S. Ct. at 3032; *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 328 (1974). No pipeline could enter into a lease-sale transaction with any reasonable expectation

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[34] This possibility is largely theoretical. Both of the pipelines involved in this case have actively sought NGPA pricing for their gas, including the production from the PLA and GLA acreage. El Paso has estimated that if these lease sales were to be held jurisdictional, it would gain as much as $4.6 billion in added revenues from the application of NGPA pricing, rather than cost-of-service pricing. Even if the lease sales are not jurisdictional, however, El Paso stands to gain only about 17 percent less.

that it would automatically be able to pass through to its customers royalties in excess of NGPA prices. *See FERC v. Pennzoil Producing Co.*, 439 U.S. 508, 517-19 (1979).

As a result, it is very doubtful that the issue presented here will ever arise again. The NGPA controls the price that pipelines may charge for their own production. If a pipeline were to agree to pay royalties in excess of the NGPA ceiling price, that would be a matter to be resolved between the pipeline and the royalty owner. The consumer could not be charged a penny more than the statutory ceiling price without express Commission approval.

C. The Decision Below Is Not in Conflict with Other Decisions

Once petitioners move beyond their contention that the *Rayne Field* test should be reformulated, their attack on the decision below reduces to a claim that the court of appeals deviated from the approach allegedly taken in other cases and misapplied the *Rayne Field* test to the facts presented here. Not only are the claimed conflicts simply nonexistent, but the entire question of the Fifth Circuit's application of the *Rayne Field* test is a highly fact-specific issue unworthy of review by this Court.[28]

The principal conflict asserted by petitioners involves the *Ship Shoal* case, another Fifth Circuit decision applying *Rayne Field*. *Ship Shoal*, however, like *Rayne Field*, and its companion case, *FPC v. Pan American Petroleum Corp.*, 381 U.S. 762 (1965) ("*Bastian Bay*"), is plainly distinguishable. *Ship Shoal* involved a 3,000-acre tract on which some 17 wells had been drilled over a five-year period, including seven oil wells with 17 completions and one gas well with two completions. 370 F.2d at 59-60.

[28] That the issue is essentially factual was acknowledged by El Paso in its Answering Brief in the court below. "While ultimately an issue of law," El Paso contended, "the jurisdictional issue is *fact-intensive*." Answering Brief of El Paso, *et al.*, at 4 (emphasis added).

"Gas was found in 46 reservoirs in 39 distinct sand zones," the court observed. "Later, drilling on five potential gas wells was commenced but completion was deferred." *Id.* at 60.[26] The FPC hearing examiner found that "the Ship Shoal gas had been 'ready for action since 1960.' " *Id.* at 65. Moreover, witnesses for the lease sellers "did not refute the evidence of Ship Shoal's imminent ability to produce gas in commercial quantities." *Id.* Based on findings such as these, the *Ship Shoal* court had no difficulty determining that the field was "proven and substantially developed" under the *Rayne Field* test. *Id.* at 66.

The facts in *Rayne Field* and *Bastian Bay* are similarly illuminating. In *Rayne Field*, 19 of a possible 26 wells had been drilled on the acreage conveyed by the agreement. *See id.* at 64. The Commission considered this a " 'fully developed' " field. *Id.*, quoting *Texas Eastern Transmission Corp.*, 21 F.P.C. 860, 861 (1959). In *Bastian Bay*, 32 of a possible 39 wells had been drilled, with 21 oil completions and 20 gas completions. 370 F.2d at 64.

In this case, by contrast, only 42 wells had been drilled on the 375,000 acres conveyed by the PLA lease sales at the time of execution of the respective agreements, an average of less than one well for each 8,900 acres.[27] The

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[26] Petitioners argue that the presence of only one dually-completed gas well on the Ship Shoal acreage indicates that the development of gas there was negligible, and thus that substantial development was not actually required in that case. *See* Northwest Pet. at 21; El Paso Pet. at 15 n.16. This contention overlooks the fact that the existence of gas in numerous reservoirs had been demonstrated by drilling. Indeed, the drilling had enabled the parties to agree upon a definite volume of reserves in place that were purchased for cash at closing—a factor not present in any of the PLAs or GLAs.

[27] Similarly, as the court of appeals noted, GLA-47, the largest El Paso agreement, covered more than 102,000 acres, on which there were only 24 wells at the time of signing of the agreement, approximately one for each 4,250 acres. Pet. App. at 15a-16a. By

largest Northwest agreement, PLA-5, provided a "dramatic example of the lack of substantial development" of the properties. *Id.* "At the time of the agreement," [28] the Fifth Circuit noted, "there were no wells on the 188,000 acres [of PLA-5].[29] By December 1977, however, 365 wells were productive." Pet. App. at 16a. The starkly contrasting fact patterns of these cases belie petitioners' claim that the decision below is in conflict with the *Rayne Field-Bastian Bay-Ship Shoal* trilogy of cases.[30]

1976, more than 700 wells had been drilled on the GLA-47 acreage. *Id.* at 16a.

[28] Northwest argues strenuously that the court of appeals should have judged the substantiality of development of the lease-sale acreage at the time the PLA agreements were closed rather than at the time they were executed. *See* Northwest Pet. at 26-29. This argument misses an essential point. Following execution, unless the agreements were defeated because Pacific Northwest was unable to obtain financing and regulatory approval for its pipeline proposal, the agreements were not conditional. Thus, once the agreements were executed, the lease sellers parted forever with the right to explore for and produce any gas underlying the subject acreage, unless Pacific Northwest proved unable or unwilling to satisfy its obligations. As a result, any post-execution development of the properties was undertaken solely for the benefit of the pipeline. The court of appeals was thus correct in focusing on the date of execution of the lease sales as the relevant time to determine Commission jurisdiction over the lease sellers. In any event, use of a later date would have made no difference. Northwest itself admits there were only 124 PLA wells on the various closing dates, Northwest Pet. at 28, less than one well for each 3,000 acres of the almost 375,000-acre PLA leaseholds, and far fewer than the 365 wells drilled on PLA-5 alone by 1977. *Cf.* Pet. App. at 16a.

[29] One witness characterized Amoco's PLA acreage as "an awful lot of goat pasture." R. 1701. After execution of the agreements and the transfer of acreage, the pipelines, in fact, *re*assigned to the respondents substantial portions of the acreage originally conveyed. For instance, over one-half of Mobil's acreage was reassigned within six years of the transfer. R. 345. By 1957, 29 percent of the 145,984 acres originally assigned by Amoco had been reassigned to it by the pipeline. R. 14,641-42.

[30] As the district court found, these cases are distinguishable on other grounds as well. *See* Pet. App. at 127a n.11, 133a.

Petitioners' other asserted conflicts are even less plausible. Several petitioners contend, for example, that the Fifth Circuit decision here is contrary to the decision of the same court in *Louisiana Land & Exploration Co. v. FERC*, 574 F.2d 204 (5th Cir. 1978), *cert. denied*, 439 U.S. 1127 (1979). *See, e.g.*, Northwest Pet. at 20 n.13; El Paso Pet. at 23; *cf.* FERC Pet. at 19. That case, however, involved a lessor's attempt to control the incidents of a sale of "proven and developed" reserves by its lessee. 574 F.2d at 208. Not only is that a very different issue from the one presented here, but two of the circuit judges who decided the *Louisiana Land* case also joined in the decision below. The contention that these two cases cannot be reconciled is thus frivolous at best.

Equally contrived is the argument that the decision below conflicts with *Cities Service Gas Co. v. FPC*, 424 F.2d 411 (10th Cir. 1969), *cert. dismissed*, 400 U.S. 801 (1971). *See* El Paso Pet. at 22; FERC Pet. at 17-18. That case involved the issue whether the spin-off of producing properties from a regulated pipeline to a nonaffiliated gas producer should permit the pipeline to charge its customers the price stipulated in its contract with the nonaffiliated company, rather than the lower cost-of-service price previously charged. *Id.* at 416-17. The Tenth Circuit's refusal to permit this transparent evasion of Commission regulation is perfectly consistent with the result reached below. Indeed, the Tenth Circuit expressly noted that, even if the Commission "had no authority over the spin-off of undeveloped gas leaseholds," it still had the power to remedy "the *consequences* of such action if it causes a detriment to the pipeline's ratepayers." *Id.* at 416 (emphasis added). In other words, whatever the Commission's authority to regulate the price collected by the nonaffiliated producer, it plainly retained the power to protect consumers by regulating the rates charged by the pipeline. As *Cities Service* indicates, such a situation is perfectly compatible with the regulatory scheme established under the Natural Gas Act.

Finally, the asserted conflict with *Mobil Oil Corp. v. FPC*, 463 F.2d 256 (D.C. Cir. 1971), *cert. denied*, 406 U.S. 976 (1972), simply does not exist. In *Mobil*, the court of appeals turned aside an effort by the Commission to extend its jurisdiction under the Natural Gas Act to encompass virtually all gas royalty agreements.[31] The Commission's desire to protect consumers, the court observed, "is not sufficient justification upon which to base an expansion of the Act to activities clearly not within its terms. Congress did not give the FPC carte blanche to take whatever action it might consider appropriate in furtherance of this purpose." 463 F.2d at 263. Distinguishing *Rayne Field* as a case involving "gas reserves [that] were known and had been substantially developed," the court held that an ordinary gas lease, which "transfers only the right to explore, develop, and market if exploration is successful," *id.* at 262, is not jurisdictional. The court noted that, just as in this case, "no royalty is paid if no gas is discovered." *Id.*[32]

In summary, the Fifth Circuit properly applied the correct jurisdictional standard in determining that the

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[31] Northwest and El Paso allege an inconsistency between respondents' position in the present case and the position taken by some respondents in an unrelated set of petitions for certiorari in *Ashland Oil Co. v. Good*, No. 83-1234; *Mobil Oil Corp. v. Batchelder*, No. 83-1248; and *Cities Service Oil Co. v. Matzen*, No. 83-1278. *See* Northwest Pet. at 25 n.18; El Paso Pet. at 17 n.20; *cf.* FERC Pet. at 22 n.17. The issue in those cases, however, is not whether lease transactions are subject to Commission jurisdiction under the Natural Gas Act, but the level of royalties payable under leases containing a "market value" clause. *See Matzen v. Cities Service Oil Co.*, 233 Kan. 846, 667 P.2d 337 (1983) (cert. pending). Contrary to petitioner's contentions, there is no conflict in the positions of the respondents involved in these two cases.

[32] The overriding royalties here are plainly payable only for gas actually produced; there were no up-front payments of the kind found in *Rayne Field*, *Bastian Bay*, *Ship Shoal*, and the Barker Dome transaction. *See* Pet. App. at 127a & n.11.

lease transactions here were not "sales of gas" under the Natural Gas Act. Its decision is not in conflict with the decisions of other courts, nor does it raise any question of law having general significance for other pending or future cases. Indeed, because of (1) the unique facts presented here, (2) the enactment of the NGPA and (3) this Court's decision in the *Mid-Louisiana* case, the decision below deals with a situation that is highly unlikely ever to recur, and which therefore does not warrant this Court's attention.

II. THIS DECISION WILL NOT ADVERSELY AFFECT THE PUBLIC INTEREST

Frustrated in their efforts to demonstrate that this case raises a legal issue worthy of review by this Court, petitioners emphasize what they contend will be the adverse impacts of the decision below on the general public. These highly exaggerated assertions do not enhance petitioners' claims.

First, several petitioners charge that the decision below will "preclude the Commission from effectively regulating the rates charged for gas produced from fields that are major sources of supply for the two major interstate pipelines that serve the western United States." FERC Pet. at 11 (footnote omitted); *see also* California Pet. at 13; Northwest Pet. at 16; Oregon Pet. at 11. This assertion is nonsensical. The thrust of the litigation initiated by the pipelines was an attempt to convert land transactions which are not regulated into sales of gas which are regulated. The courts below held that, on the facts presented, the pipelines did not make their case. That the respondents are not subject to Commission regulation, however, does not mean that the rates charged to consumers are not regulated.

In point of fact, the two pipelines have operated the San Juan Basin properties for more than thirty years, producing the gas into their systems under Commission regulation and review of the cost to their customers. The Fifth Circuit decision does not alter or restrict in any way the power of the Commission to continue regulating the cost to the pipelines' customers of the production from the leases in question. Moreover, this Court's decision in the *Mid-Louisiana* case, *see* Part I.B. *supra*, ensures that absent extraordinary relief from the Commission the pipeline production involved here will be subject to NGPA pricing. Thus, the decision below in no way limits the Commission's ability to afford West Coast consumers "a complete, permanent, and effective bond of protection from excessive rates and charges." *Atlantic Refining Co. v. Public Service Commission*, 360 U.S. 378, 388 (1959).

Petitioners also allege that the decision below has deprived western gas consumers of refunds amounting to as much as $1 billion for past periods. *See, e.g.*, FERC Pet. at 21. Petitioners fail to acknowledge, however, the extreme unlikelihood that refund of such amounts would ever be required, even if the decision below were overturned. First, only one aspect of the complex jurisdictional question is presented here. Even if this Court were to rule in favor of petitioners, the case would still have to be remanded for resolution of a long list of other difficult issues, including the res judicata and collateral estoppel questions presented by the conflicting decisions of the district court and the Commission. *See* Pet. App. at 8a-9a; *see also* note 12 *supra*.[33] Only if all these issues were resolved in the pipelines' favor would the question of refunds even arise.

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[33] Respondents have not raised these questions here inasmuch as they were not addressed by the court below.

Further, the amount of refunds, if any, is highly controverted. Various parties submitted refund claims in the remedy proceeding instituted after the Commission's jurisdictional determination, *see* note 13 *supra*. Those claims were being vigorously contested at the time the Fifth Circuit issued its decision. The evidence offered by the respondents showed that they had, in fact, received *less*, not *more*, under the lease-sale transactions than they could have received as conventional sellers under the Natural Gas Act and the NGPA.[34] An additional indication of the questionable nature of the pipelines' refund claims is provided by the settlement agreement entered into by Northwest with Phillips, a principal PLA respondent. Under that settlement, the maximum refund liability, even assuming the PLAs are found jurisdictional, is approximately $30 million, a fraction of the refund amounts originally sought by Northwest and other parties.[35]

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[34] *See* Prepared Direct Testimony of John M. Little, *El Paso Natural Gas Co., et al.*, Docket Nos. CP74-314, *et al.* (filed Jan. 3, 1983). In addition, it should be noted that even before the *Mid-Louisiana* decision, Northwest had availed itself of the option offered by the Commission to price its gas production from post-1972 wells at the applicable national rates or NGPA ceiling prices. As a result, any refunds paid to Northwest would *not* be flowed through to Northwest's customers except to the extent they related to gas from pre-1973 wells.

[35] Northwest has entered into final and complete settlements with Phillips and Getty. The settlements provide that, if these lease-sales are ultimately held to be jurisdictional, Phillips and Getty would make refunds of approximately $30 million and $2 million, respectively, to Northwest. Neither settlement was opposed by Northwest's customers or the relevant state commissions. The Commission has given both settlements final approval and has terminated with prejudice the proceedings as to Phillips and Getty. Docket Nos. CP74-314, *et al.*, Order Approving Settlement Agreement (Nov. 28, 1983) (Phillips); Order Approving Settlement Agreement (Mar. 30, 1984) (Getty).

Finally, there is a substantial question whether the Commission's equitable power to order retroactive refunds should be exercised at all in a case such as this where two courts have found that the Commission lacks jurisdiction, and where the Commission itself has previously held the very transactions at issue nonjurisdictional. *See Transportation Enterprises, Inc. v. NLRB*, 630 F.2d 421, 426 (5th Cir. 1980). Since even the Commission's order instituting the remedy proceeding left open the possibility that refunds might not be ordered, *see* Pet. App. at 30a, it is evident that the entire question of refunds is highly speculative, and the amount even more speculative.

In short, the Fifth Circuit's decision will have no real impact on the consumers of this gas or on the public generally. The only significant effect of the decision is to thwart the pipelines' attempt to escape their obligations under the lease agreements. Petitioners' unfounded and exaggerated cries of alarm should not persuade this Court to grant review in a case that presents no issue warranting its attention.

CONCLUSION

For these reasons, the petitions for a writ of certiorari should be denied.

Respectfully submitted,

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Appendix

APPENDIX

[EXCERPT]

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Docket No. CP74-314

EL PASO NATURAL GAS COMPANY

STAFF'S COMMENTS TO COMPLAINT OF EL PASO NATURAL GAS COMPANY AND REQUEST FOR AN ORDER TO SHOW CAUSE

On June 3, 1974, El Paso Natural Gas Company (El Paso) filed with this Commission a complaint in which it alleges that certain persons are demanding increased payments for gas in violation of sections 4 and 7 of the Natural Gas Act. El Paso requests that the Commission (1) issue an order requiring those persons and others who may be affected to show cause why they should not be required to file rate schedules and obtain certificates of public convenience and necessity in accordance with Sections 4 and 7 of the Natural Gas Act; and (2) to schedule a hearing for the taking of testimony and for resolution of the issues presented by its complaint.

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The Sales Are Nonjurisdictional

Should the Commission decide that it should reach the question of whether these agreements relate to sales subject to its jurisdiction, Staff respectfully recommends that a finding of no jurisdiction can be made without the necessity of formal hearing proceedings. El Paso relies

upon the Supreme Court's decision in *Rayne Field*[9] for resolution of the issues in this case. The Court in *Rayne Field* held that sales to an interstate pipeline company of leases covering proven and substantially developed reserves of gas to be sold in interstate commerce were subject to the Commission's jurisdiction. In that case several companies had entered into gas purchase contracts to sell their natural gas production in Rayne Field, Louisiana to Texas Eastern, an interstate pipeline company. Upon learning that they would be required to justify the agreed upon price upon the ground of public convenience and necessity, the producers agreed upon a different method for the sale of the Rayne Field gas. The new proposal called for Texas Eastern to purchase the producer's leasehold interests in the Rayne Field lands in which the natural gas was located. The gas reserves were proven, the same volumes of gas were to flow as under the original gas sale proposal, 19 of a proposed total of 26 wells were already in the ground and one of the sellers was to continue to do the bulk of production work. The Court concluded that the provisions of the lease-sale agreements were such that they were in economic effect conventional sales of natural gas.[10] The objective of the original proposal was to transfer large amounts of natural gas to an interstate pipeline company for resale in other states. The parties, in setting forth the lease-sale proposal were not altering their objectives, but merely the method of obtaining them.[11]

The *Rayne Field* decision is not controlling here since what was transferred under El Paso's contracts was the right to explore for and produce gas. The El Paso contracts were not part of a scheme to avoid Commission

[9] *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965).

[10] *Id.*, p. 396.

[11] *Id.*, p. 401.

regulation since many were entered into years before the Supreme Court decided *Phillips Petroleum Co.* v. *Wisconsin, et al.*,[12] which held producer sales for resale in interstate commerce subject to FPC regulation. Unlike *Rayne Field*, where the seller retained his role as producer, El Paso is the producer of gas found within these San Juan Basin leases. Where a lease-seller, such as Delhi-Taylor Oil Corporation (Delhi), agreed to drill wells upon the subject lands, they did so expressly as independent contractors who were to be compensated for such services based upon the price being charged generally for such work in the San Juan Basin. Although the agreements contain a minimum payment provision couched in terms of a take or pay clause, El Paso made the major decisions controlling development of the fields and upon a determination that a unit was not productive or was unprofitable El Paso either was to reassign such unit to Delhi or, in the case of an unprofitable unit, had the option of making such reassignment.[13] El Paso has consistently recognized their role as producer in these fields by classifying the expenditures involved with these leases as pipeline production in rate cases before this Commission. The fact that a board of arbitrators has raised payments from 10¢ to 40¢ per Mcf does not now transform these into payments made to producers for sales for resale in interstate commerce.

In *Rayne Field*, the Court was particularly influenced by the fact that the gas reserves were proven and that approximately 75 percent of the wells to be drilled on this land were drilled prior to the agreement.[14] This is in contrast to the factual situation presented by the very

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[12] 347 U.S. 672 (1954).

[13] Oil and Gas Lease Sale Agreement between El Paso Natural Gas Co. and Delhi Taylor Oil Corporation, dated January 18, 1952, (El Paso's Exh. A, p. 14)

[14] *Rayne Field*, p. 296.

contract El Paso uses to support its complaint in which only 6.25 percent [15] of the Delhi wells were drilled prior to the agreement and the contract provided for a vigorous exploration and development program.[16]

The interests retained are analogous to those which were before the Court of Appeals in *Mobil Oil Corp.* v. *F.P.C.* [17] in which the court stated:

> "While the lease by the landowner provides for a royalty in the event of the discovery and sale of gas, typically he has no control over any incident of such sale either as to quantity to be sold, the price to be paid, the identity of the purchaser or whether it shall be sold in interstate or intrastate commerce. To refer to the royalty owner as engaging in the sale is to depart from the common understanding of the words used, industry parlance, economic equivalent, or any other foundation hitherto considered a source for discerning congressional intention." [18]

Although the interest holders were conveying the right to explore, develop and produce to an interstate transporter when they sold their leases to El Paso, they had no control over any incident of sale, either, as to quantity, price, identity of purchaser or whether it would be sold in interstate or intrastate commerce. In *Mobil* the court addressed a factual situation similar to the current El Paso problem when it considered that payments to royalty owners may be in excess of applicable producer rates and that producers would then seek relief in the courts. The court stated:

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[15] Information set forth in Brief of Commission Staff and Petition to Reopen Proceedings To Complete The Record, Docket No. G-6887, *et al.*, filed June 29, 1970.

[16] El Paso/Delhi Agreement Article VI.

[17] 463 F.2d 256 (U.S. CADC, 1971).

[18] *Id.*, p. 262.

"In any event we are not persuaded that the maintenance in either state or federal courts of contract (lease) controversies between royalty owners and lessees will undercut the federal regulatory system." [19]

The court then discussed various theories under which a court could reform the terms of a contract calling for royalty payments in excess of the producer ceiling and said:

"The court handling the contract clause could avoid becoming embroiled in the ascertainment of the federal ceiling by referring that issue to the FPC . . . This would bring the FPC into the dispute between the royalty owner and the lessee-producer, but the FPC would be acting properly, on reference from the courts, rather than unduly stretching its jurisdiction and the statutory mandate to extend to royalty owners.[20]

By considering a factual situation in which contractual payments per Mcf of gas exceeded the producer ceiling, the court implicitly recognized that such a factual setting does not invoke this Commission's jurisdiction over royalty interest holders. Therefore, the fact that El Paso may now be required, under its contract, to pay 40¢ or more per Mcf of gas does not make the recipients of these payments subject to the jurisdiction of the Commission, although such payments will be reviewed for justness and reasonableness, pursuant to Section 4 of the Natural Gas Act, in El Paso's wholesale rate filings to this Commission. The producer rate ceiling will also be used as a guideline by the court reviewing the demands made by the interest holders under their respective contracts.[21]

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[19] *Id.*, p. 265.

[20] *Id.*, pp. 265-66.

[21] *Id.*, p. 265.

Conclusion

For the reasons stated above, Staff respectfully urges that the Commission deny the Complaint of El Paso Natural Gas Company and Request For An Order To Show Cause filed June 3, 1974.

Respectfully submitted,

/s/ Daniel P. Behuniak
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Washington, D.C.
July 19, 1974

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